VZCZCXRO0407
PP RUEHGI RUEHMA RUEHROV
DE RUEHKH #1718/01 3311450
ZNR UUUUU ZZH
P 261450Z NOV 08
FM AMEMBASSY KHARTOUM
TO RUEHC/SECSTATE WASHDC PRIORITY 2416
INFO RUCNFUR/DARFUR COLLECTIVE
RHMFISS/CJTF HOA

UNCLAS SECTION 01 OF 02 KHARTOUM 001718

SENSITIVE
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DEPT FOR AF A/S FRAZER, SE WILLIAMSON, AF/SPG, EEB/IFD
NSC FOR HUDSON AND PITTMAN
DEPT PLS PASS USAID FOR AFR/SUDAN
DEPT PLS PASS TREASURY FOR OIA, USED WORLD BANK, AND USED IMF
ADDIS ABABA ALSO FOR USAU

E.O. 12958: N/A
TAGS: EFIN ECON EAID PGOV PREL KPKO UNSC IBRD SU
SUBJECT: WORLD BANK COUNTRY MANAGER SEES DARK CLOUDS ON SUDAN'S
FISCAL HORIZON

REF: A. KHARTOUM 1702
¶B. KHARTOUM 1484

¶1. (SBU) SUMMARY: Sudan's World Bank Country Manager believes that falling oil prices and production, along with the global financial crisis, will confront Sudan with a "serious reckoning" in the coming two years. While Khartoum already is facing "hard decisions," the position of the autonomous GoSS, which depends almost totally on oil revenues and has no capacity to mobilize foreign financing, is even more precarious. END SUMMARY.

¶2. (SBU) In a November 25 courtesy call, newly-arrived World Bank Country Manager Lawrence Clarke shared with Charge Fernandez his perceptions of Sudan's economic circumstances. (Note: Clarke has been serving as the Bank's Manager for South Sudan, in Juba, since early this year. He will continue to divide his time between Khartoum and Juba until the arrival of his successor in Juba. End note.) CDA Fernandez observed that Sudan, both North and South, has become used to a "bonanza" in oil revenues in recent years, but that bonanza may becoming to an end. Sudan's prospects for future high oil revenues are rapidly dwindling. Not only are global prices falling, but also Sudan's production levels are beginning to shrink, and there appears to be little prospect that they will recover (ref A). The CDA asked for Clarke's estimate of how this reality will impact Sudan's economy.

Khartoum - Facing Hard Decisions
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¶3. (SBU) Clarke agreed that Sudan is facing severely constrained circumstances. Clarke believes that the Government of National Unity (GNU) in Khartoum already is making some hard decisions. These are beginning to be reflected in 2009 budget that the GNU recently submitted to the National Assembly (septel). The GNU depends on oil revenues to fund 60 percent of its budget, he noted. The GNU's draft 2009 budget forecasts a six percent deficit. Two thirds of this is to be financed via foreign borrowing, the other third domestically. "The Merowe Dam is too far along to be cancelled, but other big capital projects will have to be scaled back," he suggested. Clarke thinks that this level of domestic borrowing will further increase already serious inflationary pressures. (Note: Heretofore, Sudan's 2008 inflationary pressure has come primarily from rising import prices, making it difficult for authorities to combat with normal monetary and fiscal instruments. End Note.) Clarke noted that the GNU already is drawing down its Oil Stabilization Account (ORSA). He said that the GNU has not yet released the expenditure side of the 2009 budget, so he does not know how programs will be affected by the constrained revenues.

¶4. (SBU) Beyond falling oil revenues, Clarke thinks that Sudan's prospects will be compounded by the global financial crisis. Clarke foresees foreign capital flows, notably from Gulf investors who have

lost heavily in the financial meltdown, dwindling. Sudan faces a "serious reckoning" ahead in 2009-2010, he concluded.

Juba - In a Tight Spot
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¶5. (SBU) Turning to South Sudan, Clarke said that while the GNU depends on oil for 60 percent of its revenues, the Government of South Sudan (GoSS) is over 90 percent dependent on oil revenues, putting it in a much tighter corner. Clarke noted that the GoSS has benefited from the high global oil prices earlier in 2008, and has even been able to set aside a significant part of this year's oil windfall (ref. B). He estimated that the GoSS now has about $200 million in its Reserve Account, and that this will grow to $500 million by year's end. However, this reserve will not last long if revenues fall significantly and if the GoSS cannot control spending.

¶6. (SBU) CDA Fernandez commented that thanks to this oil windfall, GoSS President Salva Kiir so far has been able to avoid tough choices and buy social peace in the South. Clarke agreed, noting that the GoSS keeps 250,000 public-sector employees on its payroll, probably 150,000 more than are needed. The Charge added that of these 150,000 are SPLA soldiers. Clarke said that this illustrates the GoSS' dilemma. Just as almost all of the GoSS revenues come from oil, most of its expenditures go to paying salaries, with little left over for other needs, including economic development. "Khartoum will cut down projects, but Juba will have to cut down on salaries and employees," he noted. While there is a critical need for DDR in the South, the Southern economy lacks any capacity to absorb such a large number of entrants. The GoSS continues to pay redundant workers and soldiers, for fear of the social unrest that would follow their discharge. The Charge agreed that in Southern

Sudan, "R" for reintegration is the critical and most problematic component of DDR.

¶7. (SBU) Clarke concluded that South Sudan is in an extremely fragile position. Both oil prices and output are falling, removing any room to maneuver. At the same time, the South lacks any major capacity to mobilize foreign financing to tide it over.

Comment
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¶8. (SBU) Clarke's pessimistic take on the next few years corresponds closely with our own (reftel). The economic fallout from the global economic downturn is further complicating Sudan's already intractable political problems and limit the room to maneuver of both the NCP and the SPLM. This will put greater pressure on both Khartoum and Juba during a period of great political (ICC, elections, Abyei arbitration, North-South border demarcation, an incoming Obama Administration) volatility.

FERNANDEZ